

## **Marcala Coffee: Making More from a Hill of Beans**

*A February 2008 report from U.S. Embassy Tegucigalpa*

**Summary:** *Coffee has been one of the few major Honduran export success stories of recent years. Exports have nearly tripled in value since 2001. About a fifth of that improvement is said to be due to a reduction in the Honduran quality discount with respect to other exporters. With support from international NGOs and European governments, Honduran producers are trying to move further up the value chain via various certification schemes, targeted at socially and quality-conscious consumers. An increasing share of this product is going to the U.S. market. CAFTA, by strengthening Honduran intellectual property rights, is making this possible.*

### **Role of Coffee in the Honduran Economy**

Coffee is grown in 15 of Honduras's 18 departments (provinces). According to the Honduran Coffee Institute (IHCAFE) – a quasi-statal organization that provides technical and other services to Honduran coffee producers – more than 100,000 Honduran families grow coffee, and about 1 million jobs depend on the industry directly or indirectly. In contrast to neighboring countries, coffee in Honduras is produced mostly by small-holders – 90 percent produce less than 5,000 pounds a year, and very few farms exceed 30 hectares. IHCAFE claims that coffee accounts for 10 percent of Honduran GDP and 30 percent of agricultural GDP. Coffee fields are worked primarily by hand. An IHCAFE official estimated that each hectare planted in coffee generates about 40 person-days of employment a year.

According to International Coffee Organization data, Honduran coffee exports last year topped 3 million 60-kg bags for the first time, and Honduras ranked sixth among the world's coffee exporters, up from eighth in 2006. IHCAFE data show export value last year grew 16 percent to \$470 million, topping the previous record of \$430 million set in 1998, the year Honduras was devastated by Hurricane Mitch. Exports to the United States grew 70 percent to \$109 million. The United States was the second-largest market for Honduran coffee, consuming 20 percent, after Germany with 32 percent.

### **Squeezing More Value out of a Bean**

Marcala, about two hours' drive from Tegucigalpa in La Paz Department, has been famous for coffee production since German immigrants brought their know-how there with them in the early 20<sup>th</sup> century. Germany remains the largest market for Marcala coffee. But a growing share now goes to the United States, Japan, and elsewhere.

Although Marcala coffee has been sought after by European gourmet consumers for decades, quality standards in the Honduran industry as a whole have historically not been considered high. Honduran coffee has therefore traded on world markets at a

significant discount compared with coffee from neighboring Guatemala and Costa Rica. Furthermore, low-quality producers both from within and outside the Marcala region have labeled their product as “Marcala Coffee,” reducing the value of the name for the producers of the true product. Therefore, IHCAFE and other industry groups, with outside support (including from USAID and the Millennium Challenge Corporation), have devoted considerable effort in recent years to raising quality standards so as to improve the Honduran brand image in global markets – and receive a higher price.

Other growers have been able to increase their profit margins by certifying their product as organic, shade-grown (IHCAFE claims 98 percent of Honduran coffee is grown under shade), rainforest-friendly, or “fair trade,” tapping into the socially conscious consumer movement in Europe and the United States. One example of this is the Marcala-based coffee growers cooperative RAOS, established in 1997 with support from German Technical Cooperation (GTZ). RAOS now boasts 140 members, mostly from La Paz Department but also from El Paraíso, Comayagua, and Yoro departments. Directors say RAOS coffee receives a premium of \$20 a bag for being certified as organic and an additional \$10 for qualifying as “fair trade.” In addition, the international association of fair trade labelers (FLO) guarantees a floor price of \$121 a bag (current world market prices are above that floor), and RAOS exports its product directly rather than through intermediaries. The product, which sells online for \$8 a pound, was originally sold to Germany’s *GEPA* but is now also marketed through other buyers such as *Ilicafe* of Italy and *Solar Trade* and *Sustainable Harvest* in the United States. Some larger commercial producers, such as *Sogimex*, are also producing coffee under socio-eco-labeling schemes and marketing it to U.S. chains such as Starbucks.

IHCAFE staff estimate that 15-20 percent of Honduran export coffee is now certified under one scheme or another, based either on the quality of the final product or on the way it was produced. These efforts are beginning to show results. Between 2001 and 2006, while the volume of Honduran coffee exports increased 21 percent, value increased by 151 percent. Average world market prices for coffee roughly doubled during that period, according to the ICO. The rest of the increase in export value – \$49 million, or 20 percent, by IHCAFE’s calculation – represents a reduction in the Honduran “price penalty.” However, Guatemalan and Costa Rican coffee continue to trade at about a 7 percent premium over Honduran coffee, according to IHCAFE.

### ***Tasting Good vs. Doing Good***

Just down the street from the RAOS office in Marcala, IHCAFE staff have been working with Spanish Technical Cooperation since 2003 to develop a denomination of origin (DO) system for Marcala Coffee that will be recognized worldwide. Their efforts received a significant boost in 2004 when, in order to comply with the U.S.-Central America Free Trade Agreement (CAFTA), Honduras revised its intellectual property laws and established a system for registering and protecting geographical indications and denominations of origin (even though the latter were not required by the treaty). In 2005 Marcala Coffee became the first denomination of origin to be officially registered in

Central America. More than 1,500 producers are now participating in the program, and the first 11 trial batches of certified *Marcala Coffee* were shipped last year.

The goal is to produce a high-quality product that can compete with the likes of Jamaica's *Blue Mountain* and Hawaii's *Kona Coffee*, which can fetch prices upwards of \$30 a pound. Project staff expect the prime target market to be Europe, which has a DO tradition and a developed market for gourmet coffee. However, they hope to obtain recognition from the Specialty Coffee Association of America as well. And at least one grower participating in the project expects the United States and Japan, not Europe, to be the most important growth markets.

On a tour through the Marcala region February 1, the Embassy's Economic Counselor visited a medium-sized coffee farm, with on-site processing facilities, owned and operated by a Guatemalan immigrant and his Honduran wife. They produce a specialty coffee that is marketed through U.S. gourmet coffee companies *Stumptown* (Portland, Ore.), *Counter Culture* (North Carolina) and *Intelligentsia* (Chicago). According to the couple, *Starbucks* and similar/imitator chains changed U.S. coffee-drinking habits and created a new market for something "better than Starbucks." This is the market they aim to tap.

The farm also produces eco-friendly coffee certified by the Rainforest Alliance. But they are considering abandoning that line in favor of the *Marcala Coffee* DO. The reasoning is simple: the certification criteria are more or less equally stringent and costly to satisfy. But they think the market potential for a quality-based certification is greater, basically because more people are likely to be willing to pay more for a cup of coffee because it tastes good than because it makes them feel good to drink it. Furthermore, they say, many of the same objectives can be accomplished either way – the coffee tastes better if it is shade-grown and sun-dried, and maintaining quality standards requires working closely with small growers and with those who pick, sort, and process the beans, which means keeping a stable workforce, which means paying and treating them well.

### ***Limits to Growth***

A 38-percent expansion of coffee output in two years – to unprecedented levels – is straining Honduran capacity to process the beans. These bottlenecks can be resolved through investments in new plants, and some in the industry talk of a further doubling of production over the medium term. A more problematic bottleneck, according to growers and IHCAFE staff, is the availability of labor. Many of the young working-age women from the coffee-growing areas have migrated to find work in the export-processing zones (*maquilas*) in and around San Pedro Sula. There, after developing a taste for the bright lights of the big city, they are loathe to move back to the farm. Many of the young men have migrated to the United States. From there they send back regular remittance checks to their families, reducing the motivation for those left behind – mostly older workers and children – to work in the fields.

More recently, coffee growers complain of having to compete with new chili pepper and cucumber plantations in the Comayagua Valley. These larger, usually corporate operations send buses into farming villages to recruit day workers at 150 lempiras (\$8) per day – well above prevailing Honduran rural wages. In contrast, coffee growers typically pay pickers 80 lempiras per 100-pound sack, and a typical worker picks about one sack a day. At that rate, they say, labor accounts for about one-third of their production costs, with fertilizers and other inputs forming another third.

In the immediate term, IHCAFE believes that preliminary indications show that this year's coffee harvest will be down roughly 10 percent because of climate conditions. How high it will go after it rebounds will apparently depend largely on labor supply. That *maquilas*, coffee farmers, and vegetable growers are competing for workers and driving up wages is good news from the standpoint of CAFTA, as one of the principal goals of the agreement was to create more and better-paying jobs for Central Americans to give them less reason to emigrate illegally to the United States. But with or without a labor shortage, Honduran producers know they must stress quality rather than quantity to raise their incomes. They will never be able to compete with Brazil and Vietnam on volume. They have no choice but to add more value to what they produce.